

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

ANNUAL COMPLIANCE REVIEW, 2012

Docket No. ACR2012

RESPONSES OF THE UNITED STATES POSTAL SERVICE
TO COMMISSION REQUESTS FOR ADDITIONAL INFORMATION
IN FY 2012 ANNUAL COMPLIANCE DETERMINATION

In its Fiscal Year 2012 Annual Compliance Determination, issued on March 28, 2013, the Postal Regulatory Commission requested additional information from the Postal Service regarding several issues within ninety days. The Postal Service's responses to those requests follow. An unredacted version of the responses has been filed under seal in USPS-FY12-NP41.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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1. “The Commission directs that, with elimination of outbound International Reply Coupon Service, the Postal Service report on the feasibility of providing separately reported costs for International Business Reply Mail Service in the FY 2013 ACR.” (p. 147)

RESPONSE:

Given the small size of International Business Reply Mail Service ([REDACTED] in revenue and [REDACTED] pieces in FY 2012), and the resources that would be needed to calculate costs, the Postal Service submits that reporting the costs separately is not feasible.

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2. “The Commission directs the Postal Service to report on the feasibility of a special study designed to estimate the transaction volume and attributable costs of the IMTS-Inbound product within 90 days. The Postal Service is to report on estimating IMTS-Inbound transaction volumes based upon the POS system as presented in Proposal Eleven. As stated in the FY 2011 ACD, if the Postal Service ‘no longer believes that Proposal Eleven is feasible, it should propose a modification by following accepted procedures, *i.e.*, initiating a rulemaking proceeding.’ Id. The Postal Service shall also report on the feasibility of using revenues received from foreign postal operators as a basis for estimating IMTS-Inbound transaction volumes within 90 days.” (p. 166)

RESPONSE:

Background

Proposal Eleven (Docket No. RM2011-5) proposed to implement the Commission’s recommendation that the Postal Service report the financial results for IMTS-Outbound and IMTS-Inbound separately in the International Cost and Revenue Analysis (ICRA). The Postal Service proposed to utilize three data sources to develop the financial results for the two products:

- 1) IMTS-Outbound revenues, IMTS-Outbound transaction volumes, and IMTS-Inbound revenues would be obtained from Chapter 9, Part II of the ICRA Overview/Technical Description (USPS-FY12-NP5 in Docket No. ACR 2012).
- 2) To identify IMTS-Inbound transaction volume, the Postal Service would use data retrieved from the retail Point of Sale system.
- 3) With respect to costs, the Postal Service would use IOCS tallies to distribute IMTS total attributable costs between the IMTS-Outbound and IMTS-Inbound products.

Proposal Eleven was approved in Order No. 724.

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Issues

The Postal Service successfully implemented step (1) and has used that in each subsequent ICRA. However, for step (2), the volume from the non-POS offices would not be captured. As a result, IMTS-inbound volume is under-estimated. For step (3), the Postal Service repeatedly cautioned that the use of IOCS tallies to develop IMTS attributable costs is problematic. It explained that, because the number of IMTS transactions is small, it is difficult to obtain enough IOCS tallies through sampling to reliably estimate attributable cost for IMTS.

Postal Service Efforts to Address the Issues

In the FY2011 and FY2012 Annual Compliance Reports (ACR), the Postal Service relied on three data sources to develop the financial results for the two products.

As stated in the Supplemental Response to Order No. 154, Docket No. MC2009-19, the Postal Service undertook several activities in an effort to draw conclusions concerning the measures necessary to address the shortfall in cost coverage reported for IMTS. Upon review of the Postal Service's Annual Compliance Reports for 2008, 2009, and 2010, window service costs attributed to the IMTS product represented a significant portion of the volume variable costs associated with this service. However, the relatively small number of tallies (please see below) for IMTS led to relatively volatile unit costs.

| Number of IOCS Tallies | 2009 | 2010 | 2011 | 2012 |
|-------------------------------|-------------|-------------|-------------|-------------|
| Inbound | 1 | 3 | 1 | 0 |
| Outbound | 12 | 15 | 7 | 4 |

Examination of the variances in the window service costs revealed that the

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standard deviation around the estimated cost swamped the estimated cost. For 2008, the implied estimated cost of \$712,000 fell within a 95% confidence interval that ranged from \$16,000 to \$1.41 million. In FY 2011, the 95 percent confidence interval for IMTS cost coverage was 37% to 151%. For a product with such low volume, a range of this size is not likely to be useful in determining the profitability of the product. The Postal Service investigated the use of heavy sampling in IOCS for IMTS, similar to the technique used to enhance sampling for International Mail. However, unlike International Mail, where most processing occurs in relatively few facilities, IMTS activities are widely dispersed at stations and branches. No locations were identified where a reasonable sampling rate would have been likely to generate significant additional IMTS tallies.

The Postal Service also has been attempting to develop a means of grouping the tallies associated with “small” products and using additional information as a means of distributing those tallies in a more meaningful way. However, to date, no alternative distribution key has been uncovered that does not have other drawbacks (such as failing to reflect the full window transaction activity) and does not embody the same volatility as the IOCS tally system.

As a result, the Postal Service returned to the time-consuming task of accumulating observations of IMTS transactions, specifically Dinero Seguro transactions, to determine more reliably the costs associated with the IMTS product.

Because of the extremely low volume and geographic dispersion of IMTS transactions, it has not been easy to perform field studies using ordinary means of sampling. Instead, using internal databases that record the locations and dates of

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Dinero Seguro transactions, the Cost Studies and Support team identified the highest-volume offices and the times of the year which have, in the past, shown the most transactions. The study team visited nine (9) high volume retail units the week prior to Mother's Day in 2011, traditionally the peak period for IMTS transactions. The team observed a total of 36 complete purchase transactions during that week. Some of the transactions were for "new" customers, i.e. customers who did not have a frequent user card that facilitates the data entry process, or customers who forgot to bring the card.

Combined with the transactions observed in 2008, 2009 and 2010, the team has collected a total of 67 transaction observations. For all transactions, the average transaction time of 4.494 minutes fell within the 95% confidence interval that ranges from 3.820 minutes to 5.169 minutes. Note that the required sample size for a stable estimate is 521, while only 67 transactions were observed.

Although small compared to the rest of the International Mail, Outbound-IMTS volume outnumbers Inbound-IMTS. Given the tremendous difficulty in finding Outbound-IMTS transactions, the Postal Service believes it is unlikely to find IMTS inbound transactions and an IMTS-Inbound Special Study will not yield fruitful results.

Feasibility of using revenues received from foreign postal operators as a basis for estimating IMTS-Inbound transaction volumes

IMTS-Inbound revenue reported for this product represents the fees the Postal Service receives from certain foreign postal operators for cashing their inbound international money orders. In most cases, these fees are calculated on the basis of the face value of the money order and not on a per-item basis. As a result, it is not feasible to use inbound revenues received from the foreign postal operators as a basis for estimating Inbound-IMTS transaction volume.

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The Postal Service attempted to separate Outbound and Inbound IMTS in the FY 2011 and FY 2012 Annual Compliance Reports. The attempt provided relatively volatile and problematic results. In conclusion, given the small number of transactions and revenue, the separation proposed in Proposal Eleven should not be implemented going forward. The Postal Service recommends combining Inbound and Outbound IMTS revenue, volume, and costs to produce more statistically valid numbers.

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3. “The Commission concludes that the Postal Service must report within 90 days on whether the NSA that is the subject of Docket No. CP2013-38 complies with section 3633(a)(2). The Postal Service’s report shall consist of the FY 2013 monthly financial results based upon the financial model previously provided to the Commission with its Notice in Docket No. CP2013-38, updated for actual volumes. The Commission also directs the Postal Service to modify its financial model for Global Plus NSAs to more accurately develop costs, or increase the contingency factor to accommodate costs that cannot be modeled, in order to ensure that negotiated prices can generate sufficient revenues to exceed attributable costs. The Postal Service report shall describe the modifications implemented with respect to the financial model for Global Plus NSAs, and any other modifications in rates or service requirements likely to affect whether the NSA is in compliance with section 3633(a)(2).” (pp. 169-170)

RESPONSE:

Attachment1.xls, filed under seal in USPS-FY12-NP41, shows that the NSA in Docket No. CP2013-38 complies with section 3633(a)(2) with a cost coverage of [REDACTED] %.

The model has updated inputs to provide more accurate costing projections. The FY 2011 costs are replaced with data from the FY 2012 ICRA. Using a more recent source for costs results in a more accurate forecast. The model also includes actual volume and weight for January 2013 - March 2013 from PostalOne!. Including actual volume for the time periods where such information is available reduces the potential inaccuracy of the financial output compared to using a volume projection that is subject to unexpected changes. Exchange rates are updated to the maximum value over a 12 month time period rather than the exchange rate on the date of filing the model. This reduces the effect of a potential 'outlier exchange rate' on the filing date.

The following list outlines the updates made to the model:

- 02_Inputs
 - US Dollar per CDN Dollar exchange rate in [Ac] updated to the highest value from the past 12 months (1.0418 USD/CDN)

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- Total IPA and ISAL volume in [Ad] to [Ae] updated with FY2012 ICRA data
- 'aip' weight and domestic transportation cost in [Af] to [Aj] updated with FY2012 ICRA data
- Volume adjustment factors in [Aao] to [Aap]
 - Model includes actual volume for January 2013 - March 2013 in Period 1
 - Model forecasts volume for April 2013 - December 2013 in Period 2 - volume adjustment factors adjusted to reflect 9 month time period
- Inflation Indices in [Bau] to [Dcp] updated with May 2013 Global Insights
- Actual volume and weight for January 2013 - March 2013 added to model in cells [Acq] to [Bcs] - data from PostalOne!
- Historical volume updated to reflect April 2012 to March 2013 and moved to cells [Act] to [Bcv] - data from PostalOne!
- Contract Total Volume table added in cells [Acw] to [Bcy]
 - This table is used in calculations later in the model
 - Actual volume from [Acq] to [Bcs] is added to the product of the volume adjustment factors in [Aao] to [Aap] and the historical volume from [Act] to [Bcv]
- 03_Processing_Costs
 - IPA and ISAL processing costs in [Da] to [Eu] updated with FY2012 ICRA

In its response to Question 5 of Chairman's Information Request No. 8, Docket

Number ACR2012, the Postal Service explained that:

The Canada Post Corporation (CPC) rate schedules applicable to payments for Global Direct Entry Outbound Admail have detailed structures (such as per-piece charges that vary depending upon piece weight as well as machinability and presort incentives) that are not able to be explicitly considered in estimating the costs in the ICM Costing module of USPS-FY2012-NP2. As such, the treatment of the CPC charges was oversimplified; thus, the evaluation of costs for Global Direct Entry Outbound Admail was less accurate than would otherwise have resulted from a detailed analysis of mail tendered. The Postal Service is aware of the issue and plans to investigate options for obtaining better data or refining the calculations.

The "oversimplification" in the cost model for outbound Admail to Canada refers to the actual shape (long and short / small), weight per piece, and level of sortation data necessary to more accurately estimate the costs. The Canadian rate schedules are based on shape, weight per piece, and level of sortation and the investigation refers to the need to explore if those attribute data are available and how they can be

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incorporated into the model. The following proposal is the best option resulting from the investigation.

PROPOSAL:

Given that the Postal Service is invoiced by CPC on the aggregate product as a whole, it is proposed that the most accurate estimates of GDEO settlement payments for each NSA is to base payments on revenue shares rather than the current methodology of distributing the settlement costs by weight shares.

RATIONALE:

Accurately accounting for settlement costs by contract for GDEO Admail is made difficult because of the detailed CPC rate schedules for Admail. The settlement costs are by far the most significant cost element, so inaccuracy in the cost accounting by contract can lead to misjudging whether contribution is positive or negative. The ICRA currently allocates costs from aggregate (across customers) Admail settlement invoices which have in past ICRAs been distributed on a per-pound basis. Admail as a whole generated more revenue than its settlement costs plus estimated domestic handling and transportation. Using pound-shared settlement calculations led two contracts to have estimated negative contribution in ICRA 2012.

The issue is that contracts with negative contribution estimates may have performed better than estimated because the actual CPC rates are more complicated than a uniform per pound rate, and have different per piece costs based on the shipment average weight of the mail. The per piece changes break at 30g, plus for heavier items (over 50g) the schedule has an additional cost per gram. Costs also differ

The upshot is that, without knowing shipment-level details, it is more appropriate

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to allocate settlement cost based on revenue shares, which is easy to implement in the ICM Costing module. Since every rate component in the financial model is about [REDACTED] percent higher than the CPC mail payment schedule, as long as the mail is charged correctly on the Postal Service side and invoiced back to the Postal Service based on the same assumptions, no matter the weight the mail should achieve a contribution near the average. The proposed enhancement reflects the reality of the considerations involved in developing the rate tables for the GDEO contracts.

IMPACT:

In the FY 2012 ICRA, GDEO contributions for the two Global Plus NSAs were judged to be negative. Revising the ICM Costing Module to use settlement costs per dollar of revenue, all contracts show positive contribution, which mathematically is what is expected based on the structure of the USPS GDEO pricing schedule. The non-public Excel file "Attachment 1.xls," filed under seal, displays: 1) the comparison between the FY 2012 Imputed version as filed in USPS-FY12-NP2 (Revised 2-8-13) and the proposed methodology, and 2) the comparison between the FY 2012 Booked version as filed in USPS-FY12-NP2 (Revised 2-8-13) and the proposed methodology.

MECHANICS:

Attachment 1 consists of five tabs. The first tab, "GDEO Controls," provides the GDEO Admail revenue, pieces, and weights as received by the FY 2012 ACR Excel file, Inputs.xls. These aggregate totals are the basis for the calculation of the current average CPC settlement payment per pound, which is shown in cell B34. It is on the basis of that figure that the settlement payment total is currently distributed to individual

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NSA contracts based on the NSA weights.

Also shown on 'GDEO Controls' in cell B36 is the calculation of the proposed alternative basis for distributing the settlement payment total to individual GDEO NSAs. That figure represents the Canada Admail settlement payment per US Dollar of revenue charged to the NSA customer based on the USPS rate tables. As with all calculations in Attachment1.xls that are new and specific to this proposal, it is shaded green.

The "Imputed Version Before" tab provides GDEO NSA data by Contract Type, Docket, and Company Name from the Imputed version of the FY 2012 ICRA. This data was obtained from the Excel file "NSA Summary (Imputed) (Revised 02-08-13).xls", "PivotServer" tab, after filtering and reformatting. The negative contributions for the two Contracts discussed above are highlighted in red. The "Conveyance" amounts (CPC payments) were calculated in the ICRA by multiplying the Contract weight by the average CPC settlement payment per pound discussed above.

The "Imputed Version After" tab illustrates the proposed change in settlement costing methodology. In the green-shaded cells, the newly-proposed Canada Admail settlement payment per US Dollar of revenue is multiplied by the Contract revenue to obtain the estimated settlement payments. The cells shaded blue have merely had the constant values that were shown in the "Imputed Version Before" tab replaced with simple formulas that recalculate total cost and Contribution based on the new Conveyance values, and also show the pertinent subtotals.

A comparison of the Before and After tabs for the Imputed version shows that: 1) all grand totals are identical before and after the methodology change, and 2) all Contracts show positive Contribution after application of the proposed methodology, as

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expected from the logic used in the Postal Service's preparation of the detailed GDEO rate charts.

The original GDEO NSA results by Contract Type, Docket, and Company Name from the Booked version of the FY 2012 ICRA are provided in the "Booked Version Before" tab of Attachment1.xls. This data was obtained from the Excel file "NSA Summary (Booked) (Revised 02-08-13).xls", "PivotServer" tab, after filtering and reformatting. They differ from the "Imputed Version Before" results only in that the Conveyance costs were benchmarked to control totals. The benchmark factor applied to the Imputed Conveyance costs is shown in the "GDEO Controls" tab, cell B38.

Because the proposed methodology leaves total Imputed costs unchanged, the same benchmark factor used to produce the original Booked results from the original Imputed results would apply in obtaining the "After" Booked results from the "After" Imputed results. This calculation is shown in the "Booked Version After" tab. While the Conveyance figures under discussion for this proposed methodology are shown shaded in green in "Booked Version After" in order to highlight them, the Booked version of the ICRA as it now stands would naturally produce these results from the modified version of the Imputed ICRA without requiring further change.

As is the case for the Before and After Imputed results, it can be seen by comparison of the Before and After Booked results that: 1) all grand totals are identical before and after the methodology change, and 2) all Contracts show positive Contribution after application of the proposed methodology, as expected from the logic used in the Postal Service's preparation of the detailed GDEO rate charts.

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4. “The Postal Service is directed to file a report within 90 days regarding its plans to improve the financial results for Inbound Air Parcel Post (at non-UPU rates) and its plans to add EPG bilateral agreements to the competitive product list.” (p. 172)

RESPONSE:

The Postal Service is working to improve the overall performance of inbound air parcels under EPG agreements. The strategy for EPG is to renegotiate rates with our largest partners where there is a net benefit to the Postal Service, considering both inbound and outbound flows.

Bilaterals have been negotiated with Netherlands, Norway, and Germany to increase the rates for inbound EPG. Remaining high volume EPG countries will be evaluated and approached individually to renegotiate rates. The Postal Service has also implemented a performance action plan to address operational issues for EPG Parcels. The operational improvements will decrease penalty payments and result in increased revenue.

The Postal Service does not believe it is in its best interest to cease its participation under the EPG arrangement, as this would have a negative effect on the Postal Service's financial position.

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5. “The Commission concludes that the Postal Service must report within 90 days on whether the successor China Post Group NSA that is the subject of Docket No. CP2013-23 complies with section 3633(a)(2). The Postal Service’s report shall consist of the FY 2013 monthly financial results based upon the financial model previously provided to the Commission with its Notice in Docket No. CP2013-23, updated for actual volumes. The Commission also directs the Postal Service to modify its financial model for the China Post Group NSA to more accurately develop costs, or increase the contingency factor to accommodate costs that cannot be modeled, in order to ensure that negotiated prices can generate sufficient revenues to exceed attributable costs. The Postal Service report shall describe the modifications implemented with respect to the financial model for China Post Group, and any other modifications in rates or service requirements likely to affect whether the NSA is in compliance with section 3633(a)(2).” (pp. 171-172)

RESPONSE:

The attached China Inbound Competitive model filed in the nonpublic annex shows that the NSA in Docket No. CP2013-23 complies with section 3633(a)(2) with a cost coverage of [REDACTED] %.

The model uses updated inputs to provide more accurate costing projections. The FY2011 volume, weight, and costs are replaced with data from the FY 2012 ICRA. Using a more recent source for volume, weight, and cost results in a more accurate forecast. The Inbound EMS contingency percentage rate is further increased from [REDACTED] % to [REDACTED] % to show a more conservative forecast that includes an enhanced ability to account for future unexpected changes in volume, weight, or cost. The model also includes actual volume and weight for January 2013 - March 2013. Including actual volume for the time periods where it is available reduces the potential inaccuracy of the financial output compared to using a volume projection that is subject to unexpected changes. Exchange rates are updated to the maximum value over a 12 month time period rather than the exchange rate on the date of filing the model. This

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reduces the effect of a potential “outlier exchange rate” on the filing date.

The following list outlines the updates made to the China Inbound Competitive model:

- 01_Inputs
 - USD per SDR for Bilateral Agreement exchange rate in [Aa] updated to the highest value from the past 12 months (1.549481 USD/SDR)
 - EMS Contingency in [Ad] updated from [REDACTED] % to [REDACTED] %
 - Time period in [Be] to [Bg] referring to time period of cost data updated to reflect FY2012
 - Inflation Indices in [Bv] to [Dco] updated with May 2013 Global Insights
 - Volume adjustment factors in [Acp] to [Bcs]
 - Model includes actual volume for January 2013 - March 2013 in Period 1 - volume adjustment factors set to 'n/a'
 - Model forecasts volume for April 2013 - December 2013 in Period 2 - volume adjustment factors adjusted to reflect 9 month time period
 - EMS costs in [Act] to [Ecw] updated with FY2012 ICRA data
 - EMS pieces and weight in [Acx] to [Bda] updated with FY2012 ICRA data
 - Signature Confirmation and Delivery Confirmation costs in [Adb] to [Bdc] updated with FY2012 special studies
- 03_Dom_Trans_Inputs
 - Domestic transportation cost in [Ba] to [Eg] updated with FY2012 ICRA data
 - Product weight in [Ga] to [Gg] updated with FY2012 ICRA data
- 04_Stream_Mapping
 - Product volume and weight in [Ka] to [Lc] updated with FY2012 ICRA data
- 05_Product_Unit_Cost_Inputs
 - Unit costs in [Ab] to [Cc] updated with FY2012 ICRA data
- 08_Pieces-Wgt & TDues_Rates
 - Period 1 pieces and weight in [Ca] to [Dc] updated with actual January 2013 - March 2013 data from FPS